February 1, 2025

The Savings & Loans Debacle of the 1980’s

The Savings and Loan (S&L) crisis of the 1980s was a significant financial disaster that affected the United States' economy. It was characterized by the failure of about a third of the 3,234 savings and loan associations in the country from 1986 to 1995. This debacle resulted in a taxpayer-funded bailout that cost an estimated $160 billion, with $132.1 billion directly taken from taxpayers. The crisis had its roots in a series of events that began in the late 1970s, when the Federal Reserve increased interest rates in an attempt to combat inflation. This move adversely affected S&Ls, which had previously issued long-term loans at fixed interest

rates that were lower than the new, higher rates at which they could borrow. Consequently, S&Ls could not attract adequate capital from deposits and savings accounts, leading them to offer higher interest rates to attract more deposits, which in turn led to liabilities that exceeded their assets.

The situation was exacerbated by deregulation in the industry, which allowed S&Ls to pursue highly speculative investment strategies. This speculative behavior, combined with fraudulent activities among some institutions, significantly increased the losses when the crisis hit. One of the most notorious figures of this period was Charles Keating, who engaged in risky investments and

corrupt practices, leading to the collapse of his Lincoln Savings and Loan Association. The crisis highlighted the dangers of mismatched regulations, moral hazard, and the lack of adequate oversight in the financial sector.

In response to the crisis, Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which aimed to overhaul the regulatory framework of the S&L industry and prevent a similar crisis from occurring in the future. The act also established the Resolution Trust Corporation (RTC) to handle the resolution of insolvent thrifts and manage their assets. The S&L crisis serves as a cautionary tale of

the potential consequences of deregulation and inadequate supervision in the financial industry, and its effects were felt well into the 1990s, contributing to a recession and shaping subsequent regulatory reforms.